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THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

National Intelligence Council

NIC #10085-82
13 December 1982

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

THROUGH: Chairman, National Intelligence Council

FROM: Maurice C. Ernst
NIO for Economics

SUBJECT: Analysis of Possible Contingencies

1. Among the possible developments that could have major implications for the world and US economies and are generally considered plausible, though not very likely to occur, four strike me as being particularly troublesome. These are:

(1) a continued US economic recession past mid-1983;

(2) a debtors' revolt headed by Brazil;

(3) a bumper grain crop in the USSR;

(4) a large decline in oil prices.

2. I plan to put out short, informal memos on the first three contingencies, examining their implications and, for some of them, a plausible sequence of events that might bring them about. The fourth contingency, a drop in the price of oil, is extremely well covered in the Intelligence Assessment just put out by the DDI/OGI.

3. I plan to pursue these questions and other possible contingencies with DDI analysts, other government agencies, and outside contacts.

Impact of Continued US Economic Recession

There appear to be no near-term expansionary forces in the world economy outside the US which could lead the way out of the current recession. Hence everyone is waiting for US recovery, which is generally expected to begin during the first half of 1983. This memorandum would briefly assess the implications of a continued US economic recession on:

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- the industrial economies, including trade and unemployment;
- the LDC economies, including exports, financial requirements, debt service problems, and economic adjustment;
- plausible policy reactions in both industrial countries and LDCs;
- the risks for the stability of the international financial system;
- protectionist trends.

A Debtors' Revolt Headed by Brazil

The kind of debtors' revolt with the best chance of succeeding would be one headed by Brazil. If Brazil should take the lead in demanding a major restructuring of LDC debt on favorable terms, most of the Third World would almost certainly join in. What the Brazilians would probably seek would be a substantial reduction of the interest burden of LDCs for several years, as well as a stretching out of repayments and some new sources of funding. Demands such as these would be extremely difficult to handle; the entire international banking system would probably be thrown into a panic. Such a contingency could be avoided if actions were taken earlier.

The memorandum would examine the severity of Brazil's balance of payments problem. At best the Brazilians would have to cut imports 15 to 20 percent from an already extremely depressed level. If the world recession continues, and bankers shy away from Brazil, the required import cuts would be even greater. This would mean a severe decline in economic activity, on top of two years of stagnation. With the mid-term outlook for agricultural markets generally weak, and Brazil's debt service burden of enormous size, the prospects for the resumption of reasonable economic growth in Brazil are poor for several years.

The Brazilian government may decide that the game of attracting new private credit through severe austerity is not worth the candle. Although political pressures are much weaker in Brazil than in Argentina, there is a strong populist tradition there too, which could be reinforced by the political attractiveness of playing the role of LDC leader and the prospect of helping to shape the fortunes of the international financial system.

A Bumper Soviet Grain Crop

The Soviets are overdue for a good grain crop. They have had four bad crops in a row--between 160 and 180 million tons. With normal weather, they should get crops of 200 to 210 million tons. With exceptional weather they could get up to 240 million tons, or some 75 million tons more than this year. With a crop anywhere near this size, they would have to cut grain imports to very low levels because of lack of storage capacity. This would mean taking 30 to 40 million tons of Soviet imports off the world market.

The enormous growth of Soviet grain imports during 1975-81 was the main stimulus for a substantial expansion in free world grain production. The leveling off of Soviet grain imports in the past two years is partly responsible for the growing grain glut, as free world production continued to rise. Grain markets, and markets for most other agricultural products, are likely to remain soft for several years even if Soviet imports remain stable. But a precipitous drop in Soviet grain imports will force an enormous immediate adjustment in the world grain market, which will fall mainly on the shoulders of the US farmer, because of controlled prices in the European Community and Japan. This adjustment would no doubt require taking a great deal of US cropland out of production. It would also no doubt stimulate the intensity of the dispute with the EC over agricultural policy. World prices would fall sharply, benefiting the balance of payments of many LDCs in the near term, but weakening LDC agriculture, which in many countries is already in poor shape.

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